Remarks
by
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before
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and
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Introductory Comments

I want to thank you for inviting me. I think it's very timely to be here.

A lot has happened already since I joined OTS and last visited with you, just under five months ago. As a regulator, we have some very interesting and important challenges to deal with, which I'll get to in a moment. You also have competitive and other challenges to wrestle with, and at the same time some good opportunities to expand service to your communities. True, you are mostly small institutions, and the big boys may be muscling into your markets, but I also think you have a leg up on them. You know your community and your customers. And even with the advent of Internet banking – still obviously in its infancy – the continuing consolidation of the banking and thrift industries and the emergence of the big regional banks, and, not the least, the challenge of Year 2000 issues, even with all of that, you have a very important role to play in providing financial services to your communities.

Moreover, I believe your presence will continue to be needed no matter what the outcome of the debate over financial modernization and the future of the thrift charter. Let me share for a few minutes "a Washington insider's view" – such as it is.

Status of Financial Modernization

There has been some movement in the House on a modernization bill, and it looks like it may go to the floor for a vote. Even if it passes, however, we don't really know what the Senate might do. So, I have to confess, I don't know any more than you do about how the debate will pan out. I know how I'd like it to turn out. I believe there is a place in financial services for an industry that is a community-based service provider. And that's you, and your thrift and small bank brethren throughout this country. I would hate to see Congress take away directly or indirectly the option for you to determine the type of business you want to be in, whether it's commercially oriented, consumer-based or tilted toward residential mortgage lending.

Certainly the federal thrift charter has attracted attention in recent months. As you probably know, we've received applications from several large insurance corporations, a couple of brokerage firms and a handful of other major organizations such as GE Capital.

In the few instances in which we have granted charters so far, we have been very careful to make certain that consumers are treated fairly. For example, we have spelled out conditions to safeguard both the thrift institution and its customers from getting entangled in problems brought on by failure to disclose which products being offered are insured products and which are not.

The issue of how CRA will apply has also been carefully considered. Some operators are starting out on a modest basis, with limited operations and one or a few local markets. In time, however, they and others may want to expand operations in a way that will necessitate reassessment of their CRA plans and obligations. For example, say a thrift institution operating on the Internet decides to introduce nationwide mortgage lending. We've got to work on developing a meaningful application of the CRA to that scenario. The OTS is working with the other banking regulators through the FFIEC on this issue. We simply must come up with a reasonable approach that recognizes the shift from a predominantly brick and mortar structure to use of less traditional delivery methods.

Minority-Owned Institutions Uniquely Qualified to Contribute to Community Development

We all need to be concerned about whether, as technology, consolidation, and other market forces change the face of banking, some individuals and communities may get left behind. Community-based institutions in general, and minority-owned institutions in particular, can help ensure that that does not happen.

We have made considerable progress in home ownership. For example, home ownership in America reached an historic high last year of 65.7 percent of all families. There have also been major increases in home ownership rates for minorities and in central cities. However, serious gaps in home ownership still remain between white families and minority families, as well as between the rich and the poor, and between households headed by women and those headed by men. I believe you are well positioned to take the lead in your communities in providing housing and other financial services, and in a number of communities in the inner city and elsewhere you are. The problems of crime, inadequate housing, poverty and blight aren't confined to urban centers. They are evident in communities across the nation, including rural areas that have their own unique problems with economic under-development and depopulation. There, too, banks and thrifts have an opportunity to make a difference.

But what if making a difference is too large an undertaking for some individual institutions to go it alone? Well, we know from experience that economic development works well in partnership. Partnerships that provide for a sincere and concerted effort by all parties involved in the process—community leaders and residents, government, financial institutions, businesses and non-profit organizations—have the power to revitalize neighborhoods and stimulate job creation, economic and business development, and improvements in infrastructure and support services.

Commitment to the community has led more and more financial institutions into teaming with other financial service providers, the Federal Home Loan Banks, Fannie Mae and Freddie Mac, other businesses and community groups to finance housing for low- and moderate-income families. Increasingly, thrifts are helping finance other aspects of community economic development, including businesses and social services. Their commitment to community reinvestment is essential in meeting a critical need in the nation, and is consistent with a safe and sound financial system. We are actively encouraging further participation of this type by the institutions we regulate.

There are countless successful examples of institutions like yours working together to deal with housing and other community needs in their own backyards. Perhaps some of you here today are familiar with one group, the Thrift Institutions Community Investment Corporation of New Jersey. Since its beginning in 1992, TICIC has funded multifamily projects providing over 1,600 apartments, financing the development with nearly $50 million in loans made available through the organization. With changes in CRA regulations as well as growing competition, TICIC is expanding its scope. Activities now include day care centers, an office building whose tenants are mostly minority-owned businesses, and a workforce development center to train 250 people at a time in such skills as health care, computer and security services. TICIC is also working with the Small Business Administration to assess potential expansion into SBA-type projects. And another nice thing about TICIC is, you don't have to be a thrift to participate!

There are many other cooperative programs underway throughout the nation in which thrifts and banks participate. Just last month, Shell Oil Company announced pilot partnerships with both Unity National Bank in Houston and Founders National Bank in Los Angeles, in an effort to increase business development loans to minority and women borrowers. Shell will be closely evaluating the results of those pilots and, at the same time, will be seeking other opportunities for community involvement

The Neighborhood Reinvestment Corporation, on whose Board I sit as Director of OTS, is a model of success. Through its Neighborworks organizations—locally led nonprofits around the country—investments in neighborhoods have increased from 1994 to 1997 by 50 percent to $544 million. These are just a few examples of the efforts being made by concerned and committed organizations across this country.

The OTS Commitment to Help

We at OTS share this commitment. The OTS and its predecessors have a long standing history of working with the minority owned thrift industry. And while FIRREA still provides guidance on the preservation and support of minority owned institutions, OTS' activities are more the results of the agency's historic commitment to do so rather than a statutory obligation.

The OTS has demonstrated its commitment in a number of tangible ways. We have worked with almost all of the OTS-regulated minority owned institutions, individually, in one capacity or another: to help them raise capital; to provide technical assistance; to improve operating efficiency; to resolve operational problems; to identify business opportunities; and to prepare reports or applications to OTS.

For example, we have been working closely with a couple of thrifts and the FDIC to address issues related to the capital assistance notes these institutions received from the RTC, to ensure that repayment of these notes, now being administered by the FDIC, does not adversely impact the institutions. We also worked closely, over many, many months, with two other severely undercapitalized thrifts to identify, and help the thrifts secure, substantial external sources of capital that not only restored the financial viability of the thrifts but also enabled them to maintain their minority ownership.

Yet another, more broad-based effort we made was in response to a request from ALFI to provide a tailored peer group analysis of the financial performance of minority-owned thrifts versus the rest of the thrift industry. We presented the initial analysis at ALFI's annual convention last fall, and will soon be providing an updated report that incorporates the results for the 1997 year. In the interim, we have provided a set of charts that include some of our major preliminary conclusions.

The Thrift Industry is Doing Well

The OTS-regulated thrift industry had a banner year in 1997, and minority-owned thrifts have much to be proud of as well. The thrift industry set a yearly earnings record in 1997 by posting net income of $6.5 billion, while continuing to perform traditional thrift activities. Return on assets (ROA) for all thrifts was 0.85 percent.

Minority-owned thrifts shared in this success, with an ROA of 0.84 percent. While their average ROA was on a par with the industry, the median ROA for minority-owned thrifts was 66 basis points, significantly lower than the 80 basis point median ROA posted by all thrifts. This suggests that opportunities exist for many minority-owned thrifts to further improve profitability. In 1997, minority-owned thrifts had a 79 basis point net interest margin advantage over the industry as a whole. However, offsetting this advantage, general and administrative expenses at minority-owned thrifts average 79 basis points <u>above</u> the industry average. This "operating overhead" is an area where many minority-owned thrifts should look for opportunities to improve profitability, and we will be analyzing this further as well.

We are always concerned with asset quality issues. At year-end 1997, minority-owned thrifts had lowered their level of troubled assets to 1.78 percent, down from 1.97 percent in 1996. While this level remained significantly above the 1.00 percent posted by all thrifts, almost 60 percent of the minority-owned thrifts saw their troubled asset ratios improve.

Finally, equity capital for all thrifts was a record 8.3 percent, and 8.0 percent for minority-owned thrifts. These are very strong capital levels and, indeed, 97 percent of the thrift industry, including minority-owned thrifts, is well capitalized.

Year 2000 Preparation

As a regulator, I would be remiss if I passed on this opportunity to talk about your preparation for the Year 2000. I assure you that getting the industry into compliance is high on my agenda.

I assume you all now know how serious an issue this is. You must have a plan of action that is moving at a pace that will enable you to serve your customers without interruption and keep your business viable when the new millennium rolls in just under 21 months from now. Results from our first round of Year 2000 examinations completed late last year show that smaller institutions are generally not as far along in this process as larger institutions. And, unfortunately, minority-owned thrifts—at all size levels—seem to be less far along than their peers.

You also need to be concerned about your service providers' and software vendors' compliance as you are with your own internal systems. This week, the FFIEC will be issuing guidance on this issue, including detailed guidance on developing a due diligence process. The regulators will support your efforts by providing the results of service provider Year 2000 readiness examinations now underway to the serviced institutions and by examining consenting software vendors and sharing our Year 2000 readiness findings with the clients, if the vendors consent. These examination reports are meant to supplement your own due diligence efforts.

Moreover, you may find it beneficial to join forces with one another by forming user groups, or hiring auditors, to evaluate and test service providers' and software vendors' Year 2000 efforts. You will have far more influence working together than working individually. If service providers and software vendors refuse or are unable to participate in Year 2000 readiness efforts, you need to report that information to your regulator quickly.

The pressure on you and on regulators will intensify as we approach the "switching" hour. We will have a much better picture of how well the industry is progressing toward remediation after completing the on-site examinations of institutions now underway.

I will warn you, however, that we are seeing more "needs to improve" institutions than we did the first time around. This is, in part, because we chose to go first to institutions having more problems, but the numbers still are troubling. We will follow up on all unsatisfactory situations through various means, and for the more serious cases, we are contemplating appropriate formal enforcement action.

The FFIEC agencies have formed a multi-discipline working group whose task is to develop uniform approaches to contingency plans designed to mitigate systemic risks. The task force also is organizing a team of regulators with a variety of skills and perspectives whose goals are to gather potential work-around solutions in the event of technological failures; ensure consistent application of our supervisory and resolution strategies; and develop a better understanding of the interdependencies of depository institutions' systems, as well as the likely consequences of encountering corrupt data. This effort will begin later this month.

In addition to the direct exchange through the examination process, we at OTS are bolstering communications with the industry in other ways. I hope you have seen the newsletter we started in January called MMillennium. We are posting the newsletter each month in the Year 2000 section of our Internet web page – at www.ots.treas.gov. You'll also find hot links to key Y2K sites of other sources, such as the FFIEC. I urge you to have your staff check all of these sites on a regular basis.

Our goal in all of these activities is to make certain you achieve compliance in good time. Failure to do so will hurt your customers, and think what it will do to your institution. We must keep at this task until the weakest link in the industry is renovated. If you haven't already figured it out, you should expect that bringing your computer systems into Year 2000 compliance will raise your G&A costs. My advice is that it's better to make a reality check on costs now than to get a shock when the full bill comes due.

Other Electronic Technology

Law and technology are coming together in another way that offers the thrift and banking industries an opportunity to reach out to a segment of the community they may never have served before – the unbanked. As you know, beginning January 1, 1999, most federal payments, such as Social Security checks, will be made electronically. Although there will be liberal provisions for waivers, many individuals who do not already do business with a depository institution will begin to establish and designate accounts to receive the payments, or the government will set up an Electronic Transfer Account, or ETA, at a federally insured financial institution in their name. These ETAs will be provided at reasonable cost and with the same consumer protections as any other accounts at the financial institution.

Keep in mind that many of these people may currently cash checks at your institution, but don't maintain an account. Thus, they are potential new customers for you. I strongly urge you to consider ways to bring these people into your institutions voluntarily through development of appropriate products, outreach and marketing. And I suggest you seriously consider whether partnering or subcontracting for the ETAs might be good business for you.

Concluding Remarks

A point I want to drive home as I conclude my remarks today is this: as we continue to debate issues of financial modernization, and even the continued existence of the federal thrift charter, let us recognize that the nation needs to allow financial institutions to have a choice, and a choice to have a community focused housing specialty. Such institutions have proved their value by enabling more Americans to own their homes, and by increasing participation in small business lending. Who better to understand and serve the needs of the local community than a financial institution that is focused on the community it serves, whose owners are for the most part members of the community, and that has shown initiative and creativity in devising new products to serve that community.

Whether you are a bank or a thrift, those of you present in this room today have a lot to contribute to the housing needs of America and to the economic development of our communities, large and small, urban, suburban and rural. I believe that we regulators can help to preserve and promote your industry and that you, in turn, can help preserve and promote your communities. Thank you.